ORISSA HIGH COURT

Commissioner of Income-Tax

Vs

East Construction Equipment

C. Nos. 122 and 123 of 1975

(R.N. Misra and Panda, JJ.)

22.08.1977

JUDGMENT

R.N. Misra, J.

1. These are two references under Section 256(1) of the I.T. Act of 1961 (hereinafter referred to as the "Act"), made by the Cuttack Bench of the Income-tax Appellate Tribunal at the instance of the revenue and the following question has been referred for the opinion of the court:

> "Whether, on the facts and in the circumstances of the case, the interest paid on loans taken for the purchase of Government Loan Bonds was an admissible deduction ?"

2. The assessee is a registered firm mostly carrying on business in supply of machineries to Government departments. The relevant years of assessment are 1968-69 and 1969-70. The short facts relevant to appreciate the point raised are these: The State Government of Orissa decided to give preferential treatment in the matter of placing of orders for supply of materials to parties holding State Government Loan Bonds. On September 14, 1966, the Chief Engineer of the Rural Engineering Organisation wrote a letter to the assessee that since it had agreed to subscribe ₹ 5,00,000 for investment in State Government Loan Bonds, 1978, orders for supply of 100 MECE brand Hand Road Rollers--3 tons of ballast weight made of steel casting were placed with it and an advance of rupees three lakhs nineteen thousand and three hundred fifty being the ninety per cent. price of the 100 rollers excluding sales tax was sanctioned to be paid. On 15th of September, 1966, the assessee received the said advance amount. On 16th of September, 1966, it obtained two loans from the Andhra Bank Ltd., totaling ₹ 3,92,000 by investing which the assessee purchased Government Loan Bonds of the value of rupees four lakhs. During the years 1968-69 and 1969-70, the assessee claimed a sum of ₹ 24,933.97 and ₹ 9,517.42, respectively, as deductible expenses as those amounts had been paid to the bank by way of interest on the said two loans.

3. The ITO found that the advance received from the department against orders had not been

fully utilised by it and a part of it had been allowed to be used by a firm by name M/s. Das & Co. of Baripada, which had common partners with the assessee-firm and no interest had been charged for the accommodation. Accordingly, the ITO disallowed the claim for deduction of both the amounts.

4. In appeal before the AAC, the assessee produced the letter of 14th September, 1966, given by the Chief Engineer to which we have already referred. The AAC did not accept the assessee's stand by saying that there was no evidence to establish that if the assessee had subscribed for Government Loan Bonds, any preference was to be shown to it in the matter of obtaining orders for supply of materials. He further relied on the fact that the advance was not utilized for the purpose of purchasing Government Loan Bonds and the loan taken from the bank was more for the purposes of investment than for purposes of business. He further found that the assessee had not received any interest on the loan bonds and payment of interest to the bank was not admissible in view of Section 19 of the Act.

5. The assessee carried further appeals to the Appellate Tribunal and maintained that the letter of the Chief Engineer clearly indicated about the preference and the investment in Government Loan Bonds had been made as a measure of commercial expediency and for boosting up business. The Tribunal found as a fact that the loan taken from the bank had been invested in the purchase of Government Loan Bonds and the purchase of loan bonds was in the course of the business activity of the assessee. The assessee did not intend to create a capital asset when it purchased the loan bonds and this fact was manifest from the disposal of the bonds in the following year. Taking a sum total view of the matter, the Tribunal found that the claim of deduction was admissible in both the years and accordingly it set aside the addition by the ITO and vacated the order for adding back.

6. It is appropriate that we collate the findings of the Tribunal before we examine the several contentions of the learned standing counsel for the revenue. The Tribunal has found :

> "It is not in dispute that the assessee had borrowed money from the Andhra Bank which was invested in the purchase of Government Loan Bonds and since the purchase of Government Loan Bonds was in the course of business transactions of the assessee in supplying road rollers, borrowing of the money from the bank is directly connected with the carrying on of assessee's business...The fact that almost within a year of purchase of the bonds, they were sold only shows that the only object of the assessee in purchase of the loan bonds was to obtain the Government orders for its products and not hold it as its investment....The fact of borrowal of the money from the bank for the purchase of the loan bonds and the money borrowed having been utilised for the said purpose is not disputed by the department and, on the facts narrated above, we hold that the purchase of Government Loan Bonds was directly connected with and was an integral part of the business activity of the appellant in supplying its products to the Government..."

7. Learned standing counsel contends relying on the condition mentioned in the letter of the Chief Engineer that the advance was to be fully utilised in the purchase of the State Loan Bonds ; that it was not open to the assessee to extend accommodation to its sister concern in breach of the

condition and without charging interest in its turn take a loan from the bank and pay interest for it and yet claim payment of interest by it to the bank as a deduction. Reliance is placed in support of such submission on a Bench decision of the Karnataka High Court in the case of *Commissioner of Income Tax v. United Breweries*[1] The facts of that case were somewhat peculiar. Therein, the assessee, a public limited company, carried on the business of manufacture and sale of beer. It borrowed funds from outsiders on which it paid interest while in its turn advanced funds to its subsidiary company without interest. The ITO took the view that as interest was not charged by the assessee on the advances made to its subsidiaries but interest was paid by the assessee on its own borrowings, part of the interest paid for its borrowings was for non-business purpose. It is difficult for us to extend the ratio of that case to the facts before us. The revenue authorities have not recorded a finding as to how much of the money out of the advance given by the Government department had been given by way of accommodation to M/s. Das & Co. without charging interest. It is not also known as to when that accommodation was extended. It may not be wrong to assume in the absence of any finding in the matter of the period and extent of accommodation that the bulk of the advance had been utilised for the assessee's other business purposes and a part of it some time later had been given to the other firm. The contention raised by learned standing counsel had never been pointedly advanced before and, therefore, the factual aspect involved in the contention has not been examined and no finding has been recorded.

8. It was next contended that the loan bonds having been encashed before the due date and no interest having been earned thereon, the deduction claimed is not admissible. In support of such a proposition, reliance is placed on a Bench decision of the Kerala High Court in the case of *Catholic Bank of India Ltd. v. Commissioner of Income Tax*[2] In the Kerala case, loss incurred by the assessee-bank in obtaining repayment of amounts covered by Treasury Savings Certificates before the expiry of the period for which the certificates had been issued was under consideration and the court was of the view that such a loss was of capital nature and was not allowable. To the facts of this case, the ratio in the said decision has absolutely no application.

9. Learned standing counsel thereafter relied upon a Bench decision of this court in the case of *Commissioner of Income Tax v. Patnaik & Co. (P.) Ltd*[3]*.,* (see page 388 infra), where the loss sustained in untimely disposal of Government Loan Bonds was held not to be admissible. It was found that it was not the business of the assessee to deal in Government Loan Bonds.

10. Interest-bearing loan bonds of Government were sold at a loss and the court held that loss arising out of disposal of such loan bonds could not be a business loss because the court found that the loan bonds were a capital asset. The ratio in Patnaik & Co.'s case (see page 388 infra), therefore, has also no application to the present case. In fact, a Bench of this court has already drawn the distinction on the lines
contended for in the judgment *(Commissioner of Income Tax v. Industry and Commerce Enterprises (P.) Ltd*[4]*.)*. Dealing with the matter, this court has observed:

> "We agree with the principle laid down in the aforesaid case but are afraid that the ultimate decision in this case must be taken to be one of fact. Admittedly, the letter of the Chief Engineer of the Rural Engineering Organisation (dated 14-8-1965) is prior to the investment in Government loans as would appear from the appellate order of the Tribunal. There is a further finding that business was secured contemporaneously from the very

department. This is not a case where the assessee claims that the loan bonds were purchased for any enduring return. On the other hand, the finding is that there is a boosting up in the business in the year itself. The link which was wanting in the reported decision of this court appears to have been found by the Appellate Tribunal as a fact. In these circumstances, there is no warrant for the contention of the learned standing counsel that the purchase of the Government Loan Bonds was in the nature of investment and, therefore, resulted in capital assets, loss wherein could not be admitted as revenue expenditure."

11. We are in respectful agreement with the view indicated by the Division Bench in this case and would reiterate that the ratio in Patnaik & Co.'s case (see page 388 infra) must be confined to its own facts.

12. According to assessee's counsel on the findings recorded by the Tribunal which are based on evidence and which are all factual and, therefore, binding on this court, the only conclusion that can be reached is that the expenditure incurred in the matter of payment of interest would be admissible as being squarely covered by Section 36(1)(iii) of the Act. Section 36, as far as relevant, provides:

"36. (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28--...
(iii) the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession."

13. Assessee's counsel relies upon the decision of the Bombay High Court in the case of *Calico Dyeing and Printing Works v. Commissioner of Income Tax*[5] where Chagla C.J., dealing with the corresponding provisions of Section 10(2)(iii) of the 1922 Act, held that interest paid even on a capital asset was an admissible deduction. The ratio of the decision of the Madhya Pradesh High Court in the case of *Ram Kishan Oil Mills v. Commissioner of Income Tax*[6] and the principle indicated in the Supreme Court decision in the case of *State of Madras v. G. J. Coelho*[7] support the same conclusion. As observed in the case reported in [1964] 53 ITR 186, in ordinary commercial practice, payment of interest is taken as a revenue expenditure. On the finding by the Tribunal that the purchase of loan bonds with the loan from the bank was for boosting up business, we are inclined to agree with the conclusion reached by
the Tribunal and hold that payment of interest had been rightly allowed as deduction.

14. Our answer to the question referred, therefore, is :

14.1. On the facts and in the circumstances of the case, interest paid on loans taken by the assessee for purchase of Government Loan Bonds was an admissible deduction.

15. The assessee shall have its costs of the references. Consolidated hearing fee is assessed at rupees one hundred.

Panda, J.

16. I agree.

Cases Referred.

[1][1973] 89 ITR 17
[2][1967] 64 ITR 514
[3](1978) 2 Comp LJ 508 (Ori)
[4] dated 28th November, 1975, in S.J.C. No. 207 of 1974
[5][1958] 34 ITR 265
[6][1965] 56 ITR 186
[7][1964] 53 ITR 186